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No. 02-458

IN THE

Supreme Court of the United States

RAYMOND B. YATES, M.D., P.C., Profit Sharing Plan;
RAYMOND B. YATES, Trustee,

Petitioners,

v.

WILLIAM T. HENDON, Trustee,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

REPLY BRIEF

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ARGUMENT

I. The Bankruptcy Trustee's Mischaracterization Of The Facts Does Not Show That Yates Is An Employer As Defined In ERISA.

The question presented in this case is whether a one hundred percent (100%) shareholder of a corporate employer, a partner or a sole proprietor can qualify as a "participant" in an "employee benefit plan" as those terms are defined in the Employee Retirement Income Security Act of 1974 ("ERISA") and thus be entitled to enforce the restriction against alienation contained in 29 U.S.C. § 1056(d) of ERISA and 26 U.S.C. § 401(a)(13) of the Internal Revenue Code. The Bankruptcy Trustee's Brief avoids the question presented in this case and attempts to confuse the issue presented by directing this Court's attention to whether Raymond B. Yates ("Yates"), in his individual capacity, is an "employer" for purposes of ERISA. First, such an exercise is irrelevant to the outcome of this case and there is no factual or legal basis for this argument. Second, even if one was to assume that Yates was an "employer" as alleged by the Bankruptcy Trustee, there is no provision in ERISA that prevents Yates from also being an "employee" and "participant" in an "employee benefit plan" as those terms are defined in ERISA. DOL Regulation 29 C.F.R. § 2510.3-3 provides that an employee benefit plan exists if at least one participant other than the sole owner of a corporation or sole proprietorship or a partner in a partnership participates in the plan. Therefore, 29 C.F.R. § 2510.3-3 contemplates that owner-employees may participate in an employee benefit plan as an employee of the entity.

The Bankruptcy Trustee alleges that Yates, in his individual capacity, is an employer and simply ignores that Raymond B. Yates, M.D., P.C. is a legal corporation that is the Plan Sponsor of the Profit Sharing Plan and the employer of Yates. The Bankruptcy Trustee's argument ignores fundamental principles of corporate law and, if adopted, would open the door for unlimited individual liability of corporate officers for actions taken on behalf of the corporation.

The Bankruptcy Trustee points out that Yates is the trustee of the Raymond B. Yates, M.D., P.C. Profit Sharing Plan ("Profit Sharing Plan") and as such "made investment decisions and directed the use of the plan's assets." (Brief of Respondent, page 10). The Bankruptcy Trustee further alleges that these actions are not consistent with Yates' status as an employee and that "[c]learly, the individual Debtor controlled the operations of the plan and was acting directly in the capacity as an 'employer, or indirectly in the interest of an employer in relation to an employee benefit plan,' within ERISA's definition of 'employer.' (11 [sic] U.S.C. § 1002(5))."[1] This simply is not true. Yates was acting as a **trustee** of the Profit Sharing Plan, not an employer when he was taking actions on behalf of the Profit Sharing Plan. The duties of the Profit Sharing Plan's trustee are described

1. The Bankruptcy Trustee states that Yates, in his individual capacity, was acting "indirectly in the interest of an employer." (Brief of Respondent, page 10). This argument is based on the definition of "employer" under ERISA § 3(5) [29 U.S.C. § 1002(5)]. The Department of Labor ("DOL") has addressed the phrase acting "indirectly in the interest of an employer" in several opinion letters. The DOL focuses on whether certain associations may be an "employer" for purposes of establishing an employee benefit plan. *Cf.* DOL Opinion Letter 90-19A. The phrase that the Bankruptcy Trustee relies on has not been used by the DOL to make a shareholder of a corporation the "employer" for purposes of ERISA.

in Article 16 of the plan document. (JA 231a-246a). These duties specifically include the investment of Profit Sharing Plan assets. *Id.* Therefore, Yates' actions in relation to the plan assets were in conformity with his duties as a plan trustee and do not foreclose the determination that Yates was an employee of Yates, P.C.

The Bankruptcy Trustee further attempts to confuse the issue presented in this case by emphasizing that the corporation, Raymond B. Yates, M.D., P.C. ("Yates, P.C."), is the Plan Administrator of the Profit Sharing Plan. (Brief of Respondent, page 9). Again, the fact that Yates, P.C. is the plan administrator has no impact on the question presented in this case of whether Yates individually may be an "employee" and therefore a "participant" in an "employee benefit plan." The fact that Yates, P.C. exercised its duties as provided in Article 15 of the Profit Sharing Plan (JA 222a-230a) does not dictate whether Yates, in his individual capacity, is an employer or impact the decision of whether Yates may be a participant in the Profit Sharing Plan.

In fact, ERISA § 403(c) [29 U.S.C. § 1103(c)] specifically provides that "[a]ny employee benefit plan may provide – (1) that any person or group of persons may serve in more than one fiduciary capacity with respect to the plan (including service both as trustee and administrator; . . . ." *Id.* ERISA § 3(10) [29 U.S.C. § 1002(10)] defines the term "person" as an "individual, partnership, joint venture, corporation, mutual company, joint-stock company, trust, estate, unincorporated organization, association, or employee organization." *Id.* Therefore, ERISA specifically allows for a corporation to be appointed as the trustee and plan administrator.

Further mischaracterizations by the Bankruptcy Trustee include the statement that "[a] loan was made to himself [Yates] which was clearly prohibited in the first place and non conforming in its terms even if initially authorized. (JA 207a and 67a-69a)." (Brief of Respondent, Pages 9-10). The evidence simply does not support this allegation. Article 12 of the Profit Sharing Plan governs the provision of loans. Section (g) of Article 12 provides

> (g) No loans will be made to any shareholder-employee or Owner-Employee. For purposes of this requirement, a shareholder-employee means an employee or officer of an electing small business (Subchapter S) corporation who owns (or is considered as owning within the meaning of Section 318(a)(1) of the Code), on any day during the taxable year of such corporation, more than five-percent of the outstanding stock of the corporation.

(JA 207a).

In order for the loan to Yates to be improper, Yates must have been either a shareholder-employee or Owner-Employee. The Bankruptcy Trustee states that "[t]he corporation [Yates, P.C.] at issue was not a Sub-Chapter S corporation." (Brief of Respondent, Page 9). Accordingly, there is no dispute that Yates is not a "shareholder-employee" as defined in Article 12(g) above. The definition of Owner-Employee is contained in Section 2.41 of the Profit Sharing Plan, which provides

> 2.41 "Owner-Employee" shall mean an individual who is a sole proprietor, or who is a partner

> owning more than ten (10) percent of the capital or profits interest of the partnership.

(JA 105a).

It is undisputed that Yates, P.C. is not a sole proprietorship or partnership. Yates, P.C. is a corporation. (JA 35a-36a). Accordingly, Yates is not an "Owner-Employee" as that term is defined by the Profit Sharing Plan. Therefore, the loan to Yates from the Profit Sharing Plan was not "clearly prohibited" as alleged by the Bankruptcy Trustee. In fact, the terms of the Profit Sharing Plan specifically allow for a loan to be made to Yates. (JA 66a-69a, 207a).

The Bankruptcy Trustee also relies on 29 U.S.C. § 1301(b)(1) as a basis for denying Yates' employee status. 29 U.S.C. § 1301(b)(1) is part of Title IV of ERISA governing defined benefit plans. The Profit Sharing Plan in this case is a defined contribution plan governed by Title I of ERISA. (JA 83a and 29 U.S.C. § 1002(34)). Reliance by the Bankruptcy Trustee on the provisions of Title IV of ERISA regarding the establishment of the Pension Benefit Guaranty Corporation and the definitional terms of that title have no bearing on this case.

II. The Bankruptcy Trustee's Argument That Yates Must Be An Employer In Order To Advance The Policies Behind ERISA Is Without Merit.

The Bankruptcy Trustee argues on page 12 of his Brief that Yates must be classified as an employer instead of an employee because failure to do so "could inhibit the other purpose [of ERISA] of prohibiting employer abuse." (Brief

of Respondent, page 12). This argument ignores that fact that even if Yates were classified as an employer and thereby denied participation in the Profit Sharing Plan, such classification would not prevent him individually from acting as a plan trustee or the corporation acting as the plan administrator. It is in these capacities that the potential for abuse exists, not in the capacity as a Profit Sharing Plan participant. The fiduciary duty standards contained in ERISA protect the Profit Sharing Plan and its participants from abuses by trustees and plan administrators. Therefore, the Bankruptcy Trustee's argument is without merit.

III. The Bankruptcy Trustee's Reliance On *Watson v. Proctor (In Re Watson)*, 161 F.3d 593 (9th Cir. 1998) Is Misplaced.

On pages 12 through 14 of his brief, the Bankruptcy Trustee relies on the case of *Watson v. Proctor (In Re Watson)*, 161 F.3d 593 (9th Cir. 1998) in support of his argument that Yates must be classified as an "employer" for purposes of ERISA. In fact, the Ninth Circuit's decision in *Watson* supports Yates' position in this case. In *Watson*, the Ninth Circuit held that the sole owner and the **sole** participant in a plan may not be an employee and participant in an employee benefit plan as defined in ERISA. This is consistent with a plain reading of 29 C.F.R. § 2510.3-3. This regulation provides

> (a) General. This section clarifies the definition in section 3(3) of the term "employee benefit plan" for purposes of Title I of the Act and this chapter. It states a general principle which can be applied to a large class of plans to determine whether they constitute employee benefit

> plans within the meaning of section 3(3) of the Act. Under section 4(a) of the Act, only employee benefit plans within the meaning of section 3(3) are subject to Title I.
>
> (b) Plans without employees. For purposes of Title I of the Act and this chapter, the term "employee benefit plan" shall not include any plan, fund or program, other than an apprenticeship or other training program, under which no employees are participants covered under the plan, as defined in paragraph (d) of this section. For example, a so-called "Keogh" or "H.R. 10" plan under which only partners or only a sole proprietor are participants covered under the plan will not be covered under Title I. However, a Keogh plan under which one or more common law employees, in addition to the self-employed individuals, are participants covered under the plan, will be covered under Title I. Similarly, partnership buyout agreements described in section 736 of the Internal Revenue Code of 1954 will not be subject to Title I.
>
> (c) Employees. For purposes of this section:
>
> (1) An individual and his or her spouse shall not be deemed to be employees with respect to a trade or business, whether incorporated or unincorporated, which is wholly owned by the individual or by the individual and his or her spouse, and

(2) A partner in a partnership and his or her spouse shall not be deemed to be employees with respect to the partnership.

29 C.F.R. §§ 2510.3-3(a), (b) and (c).

It is clear from a plain reading of this regulation that Yates should not be excluded from being a participant in the Profit Sharing Plan because other non-owner employees participated in the Profit Sharing Plan. The regulation specifically states that where one or more common law employees participate in a plan in addition to the "self-employed individual," the plan is covered under Title I of ERISA.

IV. The Bankruptcy Trustee Is Seeking To Alienate Assets Of The Profit Sharing Plan In Contradiction Of This Court's Holding In *Patterson v. Shumate*, 504 U.S. 753 (1992).

The Bankruptcy Trustee denies that it is seeking to alienate assets of the Profit Sharing Plan but admits that he "is seeking to recover a preference from the Profit Sharing Plan and its Trustee under the preference provisions of the Bankruptcy Code, 11 U.S.C. § 547." (Brief of Respondent, Page 5). The Bankruptcy Trustee's assertion does not change the desired result of his action against the Profit Sharing Plan and its Trustee. The Bankruptcy Trustee is seeking to disgorge assets from the Profit Sharing Plan belonging to Yates, a participant in the Profit Sharing Plan. In response, Yates, in his capacity as trustee of the Profit Sharing Plan, is fulfilling his fiduciary duty to protect the interests of the Profit Sharing Plan. If the decisions of the lower courts stand, Yates' interest

in the Profit Sharing Plan will be alienated in contradiction of this Court's holding in *Patterson v. Shumate*, 504 U.S. 753 (1992). The decision of this Court in *Patterson* held that the anti-alienation provision of an ERISA-qualified plan, such as the Profit Sharing Plan in question in this case, is enforceable against the Chapter 7 Trustee to prevent plan assets from being alienated. Accordingly, the Bankruptcy Trustee cannot recover the avoidable transfers from the Profit Sharing Plan because to do so would amount to an alienation of plan assets. In *Patterson*, this Court held that "applicable nonbankruptcy law", for purposes of the Bankruptcy Code provision excluding from the debtor's estate interest in property subject to a restriction on transfer enforceable under applicable nonbankruptcy law, was not limited to state law, and specifically included ERISA and other federal law.[2]

This Court has also declined to recognize any exceptions to ERISA's anti-alienation provision *outside* the bankruptcy context. *Patterson*, *supra*, 504 U.S. 763 (citing *Guidry v. Sheet Metal Workers National Pension Fund*, 493 U.S. 365 (1990)). In *Guidry*, this Court held that a labor union could not impose a constructive trust on pension benefits of a union official who breached his fiduciary duties and embezzled funds from an ERISA-qualified plan. In *Patterson*, this Court determined that it would not recognize any exceptions to that provision *within* the bankruptcy context because to do so would create the possibility that creditors could engage in

2. It is interesting that the Bankruptcy Trustee concedes that the Internal Revenue Code includes shareholders within the definition of "employee" because the Internal Revenue Code, like ERISA, has an anti-alienation provision, 26 U.S.C. § 401(a)(13), which Yates would argue is applicable nonbankruptcy law for purposes of *Patterson*.

strategic manipulation of the bankruptcy laws in order to gain access to otherwise inaccessible funds. *Patterson*, *supra*, 504 U.S. at 764. Accordingly, it is clear that the Bankruptcy Trustee's attempt to alienate the assets of the Profit Sharing Plan should not be allowed. The Bankruptcy Trustee cannot deny that he is seeking to remove (Yates would argue "alienate") Profit Sharing Plan assets from the Profit Sharing Plan.

CONCLUSION

The Bankruptcy Trustee has not articulated any legal or factual basis that would prevent Yates from being an "employee" of Yates, P.C. and therefore a participant in the Profit Sharing Plan. For the reasons cited in Petitioner's Brief and this Reply, this Court should reverse the decision of the Sixth Circuit Court of Appeals holding that Yates is not an employee/participant in the Profit Sharing Plan, should overturn the grant of summary judgment in favor of the Bankruptcy Trustee and grant summary judgment in favor of Yates and the Profit Sharing Plan based on the fact that Yates is an employee of Yates, P.C., a participant in the Profit Sharing Plan and is entitled to enforce the Profit Sharing Plan's anti-alienation provisions as outlined in *Patterson*.

Respectfully submitted,

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